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C O N F I D E N T I A L SECTION 01 OF 03 MUSCAT 000722

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TAGS: PREL ECON EFIN ENRG MU
SUBJECT: OMAN WEATHERS GLOBAL FINANCIAL CRISIS

REF: A. MUSCAT 486
¶B. MUSCAT 466

Classified By: Ambassador Gary A. Grappo for Reasons 1.4 (b and d)

SUMMARY

¶1. (C) Despite public assurances from officials that Oman's economy has not been affected by the global financial crisis, the Sultanate's stock market dropped by almost 40% over the last five months while its banking system, formerly flush with cash, now suffers from a lack of liquidity. Local business contacts have expressed concern over weakness in the financial sector, as well as the potential negative impact on the economy if a major business failure were to occur in Dubai. The Omani press generally applauded the financial rescue package adopted by the U.S. Congress, but the Grand Mufti of Oman allegedly stated that the financial crisis heralded the long-term decline of the U.S. and chided Muslim leaders for pursuing Western capitalism rather than Islamic principles. Even with much tighter credit, a sharp market downturn and lower oil prices, Oman's economic growth should continue thanks to government spending on big infrastructure and development projects. End Summary.

MARKET NOSE DIVE

¶2. (U) The index for the Muscat Securities Market (MSM), Oman's national corporate equities exchange, closed on October 12 at 7,121.32 points, down more than 38% from its monthly high average of 11,555 points in May 2008. On October 7, the MSM fell by 561.25 points, losing almost 7.3% of its value in a single day. Investors interviewed by government-owned Arabic daily "Oman" decried their "huge" losses and demanded that the government intervene to restore confidence in the market. (Note: The MSM rebounded by 5.2% on October 13 in line with other world equity markets. End Note.)

IN PUBLIC, ALL IS WELL ...

¶3. (C) In response to the MSM's steep downturn and the increasingly global nature of the current financial crisis, Omani officials have repeatedly and predictably assured the Omani public of the soundness of the country's financial system, as well as the overall economic situation. On September 29, the Executive President of the Central Bank of Oman (CBO), Hamood Sangour al-Zadjali, told local media that the U.S. financial crisis "has no effect at all on the Sultanate's banking sector," and added that "the current liquidity in banks is excellent and there is no need to pump

in cash."

¶4. (SBU) On October 6, Minister of National Economy Ahmad bin Abdulnabi Macki stated publicly that the world credit crisis would have no direct impact on the general performance of Oman's economy. In a statement to the Oman News Agency (ONA), Macki assured investors that the economic situation in the Sultanate was "stable" and attributed the sharp decline of the MSM to speculation and "jittery nerves" among shareholders. Speaking from a meeting of Arab central bank governors in Marrakech, Morocco, Zadjali asserted on October 8 that "the global financial crisis has not affected fledgling economies or those in the process of moving to a market economy."

¶5. (SBU) Even more recently, Maqbool bin Ali Sultan, Minister of Commerce and Industry and Chairman of the Capital Market Authority, told local press on October 13 that "there is nothing to worry about due to the current global financial crisis." He asserted that "the slump in the MSM indices is not justified" and claimed that "the Sultanate's banks do not have any problem of liquidity." Maqbool also hailed a decline in the inflation rate and pledged that "government spending on the present projects will continue and will not be reduced in the backdrop of the oil prices slump."

... BUT CONCERNS EXPRESSED IN PRIVATE

¶6. (C) Despite the public assurances of Oman's top financial officials, local business people, bankers and government

contacts are concerned over weakness in the financial sector and its potential to drag down the Sultanate's brisk economic growth. (Note: The CBO's annual report for 2007 recorded GDP growth at 12.9%. End Note.) Just four months ago, local banks were flush with liquidity and a source of easy credit thanks to high oil prices, which prompted the CBO to reduce commercial banks' lending ratio and increase their minimum reserve requirements (refs A, B). Now, however, in a rather dramatic reversal, business leaders complain that the credit spigots have been turned way down and that there is insufficient liquidity in the banking sector.

¶7. (C) In a September 29 meeting, the Chief Operating Officer of BankMuscat, Ahmed al-Abri, expressed deep concern to Econoff about the lack of liquidity in Oman. (Note: The Omani government holds a 25 percent stake in BankMuscat, the largest financial services provider in the Sultanate. Al-Abri has been with the bank for over 17 years and is involved with all aspects of its operations. End Note.) He partially blamed local financial instability on investors who, fearing a domino effect from falling equity markets in developed economies, immediately cashed in on profits made in the Middle East or were forced to sell their appreciated holdings in the region to de-leverage their investments in U.S. stocks. In addition, al-Abri -- echoing the sentiments of many local business contacts -- stated that some local stocks were overvalued as a result of speculation, and that it was only a matter of time before the "market corrected itself."

¶8. (C) Al-Abri also shared his concern with how the CBO, in an effort to tame Oman's annual inflation rate of nearly 14 percent, had increased banks' cash reserve requirements in June to eight percent of total deposits. While acknowledging that other countries have much higher reserve requirements, al-Abri said that Oman's financial services market was much smaller than these states and that local banks were not accustomed to such a steep reserve requirement. As a result, Omani banks are now restricted in their lending and are having difficulty financing loans for expensive projects. He noted that many of the large-scale real estate development and industrial projects in Oman have been funded by financial

institutions and investors outside the Sultanate.

WORRIES ABOUT DUBAI

¶9. (C) A number of business contacts have expressed fears over the negative spill-over effect that a bankruptcy or failure of a large developer in the nearby emirate of Dubai could have in Oman. As one businessman stated, "Everyone is watching Dubai -- one big failure could trigger a panic." Al-Abri, while optimistic about the future economic outlook for Oman, said that he and others at BankMuscat were closely watching to see if funding for projects in Dubai and elsewhere in the Gulf is drying up. If so, he opined, Oman would "surely be affected" and "additional measures" may be needed to secure investment in the country. Already, some in Oman are clamoring for government intervention. Comments on a popular local internet forum called for Oman's State General Reserve Fund -- the Sultanate's primary sovereign wealth fund, which undoubtedly has taken a major hit in its own investments abroad -- to pump money into the MSM to boost the price of shares. There are also rumors that the government is considering a "buy back" of MSM shares from investors, which could be re-sold to the same investors once the market recovers to a certain level -- an approach taken by the government in the wake of the late-nineties MSM crash.

WHO'S TO BLAME?

¶10. (C) Somewhat surprisingly, local press editorials have not attempted to lay blame for the global financial crisis, and the ensuing drop of the MSM, on the U.S. (Note: "Foreign speculators" are the primary scapegoats for the MSM decline. End Note.) Neither has the government of Oman been subject to criticism in Omani newspapers for the steep market downturn. State-owned Arabic daily "Oman" lauded the U.S. financial rescue plan in an October 4 editorial, calling it a positive step in resolving the credit squeeze and a proper exercise of the role of central monetary authorities. The lead editorial in "Oman" on October 8 hailed the "successful" financial and monetary policies adopted by the Sultanate, which it claimed had shielded the country from the effects of the world-wide crisis.

¶11. (SBU) At least one very prominent Omani, Grand Mufti Sheikh Ahmed bin Hamad al-Khalili, however, has reportedly taken considerable satisfaction in the U.S. financial crisis. According to an Omani internet forum, the Grand Mufti gave a lecture on October 9 in a town in northern Oman during which he allegedly stated that the crisis showed that the U.S. was on its way out as a global superpower, while he also blamed some unnamed Arab rulers and their advisors for foolishly following a Western capitalistic economic model. (Note: The Grand Mufti's lecture was not broadcast and there is no transcript of his remarks. Moreover, Islamic banking is not permitted in Oman. End Note.) Adherence to Islamic principles, al-Khalili reportedly said, was the correct response to financial uncertainties.

COMMENT

¶12. (C) Oman's economic performance has slowed from "full steam ahead" to "proceed with caution." With falling world oil prices, investor skittishness, and increasingly tight local credit, the heyday of easy loans and a continually rising stock market is over. Still, as the government continues to pump large amounts of money into new infrastructure development projects and business ventures,

the Sultanate's strong GDP growth may continue, although likely at a slower rate compared to recent years. Slower growth and a drop in global commodity prices should also help ease inflationary pressures, but inflation will remain a concern as long as the government continues its spending spree. End Comment.
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